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Pfizer Inversion Seen Unlikely to Bring Swift Hill Action

By Alison Bennett and Laura Davison

Nov. 23 — The inability of the U.S. government to stop the $160 billion Pfizer-Allergan deal, the biggest inversion in U.S. history, will create pressure on Congress for further action—action that is unlikely to happen outside of tax overhaul, practitioners said.

"Treasury's hands are tied and Congress isn't interested in providing action in the near term," Jeffrey Paravano, managing partner at Baker & Hostetler LLP, told Bloomberg BNA Nov. 23 after the inversion was announced. "I don't think there's any interest on the Hill in strengthening the rules."

Despite statements from some lawmakers that they would be willing to consider short-term action to close tax breaks—alongside the need for a tax overhaul—practitioners said such immediate action is unlikely and that a change in the tax system is the way to go to answer the issues lawmakers are struggling with.

Big Questions

Philip West, chairman of Steptoe & Johnson LLP, said one big question on inversions that Congress is being asked is their consequences to the economy and the fisc. Another is the best way to limit any adverse consequences, and a third is whether more transactions like the Pfizer Inc.-Allergan Plc deal—which fell within all of the Treasury Department's rules—translate into greater urgency for Congress and the administration to begin serious discussions about a tax overhaul.

"While there will be increased pressure to focus on these questions, I do not believe that legislation will be enacted any time soon," West told Bloomberg BNA.

Feedback from Capitol Hill was immediate, with some members saying the transaction demonstrates the need for a revamp of the tax system and others saying swift action is needed before that.

Hatch Criticizes Tax Code

Senate Finance Committee Chairman Orrin G. Hatch (R-Utah) said in a Nov. 23 statement that the Pfizer deal "only further underscores the arcane, anti-competitive nature of the U.S. tax code. Short of a tax overhaul that will make it easier for American companies to invest and create more jobs at home, Washington ought to work together to explore viable policy-driven, apolitical solutions that will effectively combat inversions."

Finance Committee ranking member Ron Wyden (R-Ore.) said Treasury "has made it very clear that its efforts to halt the inversion virus and stop the further erosion of our tax base can only go so far."

In his own Nov. 23 statement, Wyden said comprehensive tax overhaul is the only true solution to the "concerning trend of American firms continuously looking for ways to shift their headquarters overseas"—but said it needs to happen soon.

White House spokesman Josh Earnest said at a Nov. 23 daily briefing that the administration wouldn't specifically comment on the Pfizer-Allergan deal, but said Treasury is limited in blocking inversions. He urged Congress to take action and criticized congressional Republicans for inaction on inversions and “supporting wealthy corporate interests.”

Pfizer Well Out of Reach

A key factor in the deal is that it avoids any penalties that would be imposed by tax code Section 7874 or Internal Revenue Service Notices 2014-52 and 2015-79, because the transaction doesn't meet the ownership limit of an inversion Congress wrote in 2004 when it drew a line between what it would consider a legitimate business combination rather than a tax-motivated transaction.

“The ownership level is kept well below the 60 percent threshold, so there are no slips ups there,” Robert Willens, a tax consultant in New York, told Bloomberg BNA. “I'm sure they're taking into account errors in ownership calculators so even if the IRS were to find some problems, there is no way to move 56 percent up to 60.”

The deal allows Pfizer to access $30 billion of cash overseas without having to pay U.S. taxes on it, said Ashtyn Evans, an analyst at Edward D. Jones & Co. LP. That cash could be distributed to shareholders or used in future acquisitions, potentially even another U.S. drugmaker looking to change their tax address.

Post-Merger Stock Buybacks

The newly formed company, which will be called Pfizer Plc, is expected to engage in post-merger stock buybacks, according to a news release from the companies. The government could have, but didn't, subject those distributions to “skinny down” rules, which seek to prevent U.S. corporations from decreasing their value to reduce their ownership level in the new company, Willens said.

Some had feared that Notice 2015-79, released Nov. 19, would have treated post-merger distributions as coming from the domestic entity instead of the combined company (224 DTR GG-1, 11/20/15).

Democrats in the Obama administration and both chambers of Congress have proposed legislation that would decrease the ownership percentage limits to 50 percent, making it more difficult for U.S. companies to lower their tax rate through an inversion. The bills have gotten little traction as many members of the tax-writing committees have indicated little support for anti-inversion measures absent a larger overhaul of the tax code.

Practitioners Say Deal Creates Pressure to Invert

Unless there is legislation to block the deals, U.S. companies “that haven't found a dance partner are going to feel more and more pressure to invert,” Willens said. “For Pfizer, there are only a few companies it could combine with. Very few companies were the requisite size. There is a shrinking pool of limited candidates that can support a large U.S. merger partner.”

Pharmaceutical companies, facing low interest rates, pricing pressure and global competitors, are going to look for “any opportunity to potentially lower taxes,” Evans said.

“This would be a great time to do an inversion. You could slip it in unnoticed. Pfizer is the poster child,” Willens said. “Pfizer's chairman doesn't seem to care much about that. He's aware of the potential reputational damage and figures the end justifies the means and it will all be worth it when it's left with a low tax rate.”

Global Economy Skyrocketing

Practitioners said the surge of the global economy means that the Pfizer deal will get a lot of attention from not only large companies but midsize companies as well.

Steve Klein, a partner with Gerson Preston, said, “Companies way down the food chain are constantly looking for ways to shift earnings offshore. Inversions are as relevant in the middle market as they are with the bigger companies.” They will be watching the Pfizer deal carefully to see the measures it used to conduct an inversion beyond Treasury's reach, he said.

More Hill Reaction

Other lawmakers spoke out against the Pfizer deal on Nov. 23.

Sen. Harry Reid (D-Nev.) said he thinks the deal is “a classic case of an inversion” that Pfizer conducted to “game” the system. He said “it's American taxpayers who will have to pay more. It's time for Congress to get serious, close the loopholes and prevent these kind of inversions from happening in the future.”

Ways and Means ranking member Sander M. Levin (D-Mich.) took aim at the announcement, saying it “highlights the need for Congress to take action on inversions. It is clear that Republicans in Congress need to join Democrats in stepping up to the plate to address this issue.”

Other Democrats criticizing the deal included Sen. Charles E. Schumer (N.Y.) and Rep. Rosa DeLauro (Conn.).